

Oversight Report



AIR FORCE AUDIT AGENCY PROCESS FOR DETERMINING AUDIT REQUIREMENTS AND REQUESTING RESOURCES

Report No. PO 99-6-007

August 20, 1999

Office of the Inspector General
Department of Defense

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Acronyms

AFAA	Air Force Audit Agency
MAS	Management Advisory Services

August 20, 1999

**MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE
AIR FORCE**

SUBJECT: Evaluation Report on Air Force Audit Agency Process for Determining
Audit Requirements and Requesting Resources (Report No. PO 99-6-007)

We are providing this report for your information and use. Because this report contains no findings or recommendations; no written comments were required. Therefore, we are publishing this report in final form.

We appreciate the courtesies extended to the evaluation staff. For additional information on this report, please contact Ms. Barbara E. Smolenyak at (703) 604-8760 (DSN 664-8760) (bsmolenyak@dodig.osd.mil) or Mr. Thomas Heacock at (703) 604-8756 (DSN 664-8756) (mheacock@dodig.osd.mil). See Appendix C for the report distribution. The evaluation team members are listed in the back cover.

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Office of the Inspector General, DoD

Report No. PO 99-6-007
(Project No. 90A-9021)

August 20, 1999

Air Force Audit Agency Process for Determining Audit Requirements and Requesting Resources

Executive Summary

Introduction. According to Air Force Policy Directive 65-3, "Internal Auditing," August 10, 1993, the Air Force Audit Agency (AFAA) will be placed organizationally to maintain the independence required by both public law and the standards of the U.S. Comptroller General. The Auditor General establishes the overall program for internal audits within the Air Force in accordance with existing statutes, Comptroller General audit standards, and DoD policies. The mission of the Air Force Audit Agency is to provide all levels of Air Force management with independent, objective, and quality audit services.

Objectives. The overall objective of the evaluation was to assess the process for determining audit requirements and for requesting audit resources. We also determined whether the planning process was responsive to management needs and whether policy or resource constraints impaired auditor independence. We plan to develop a best practice report based on this review and similar reviews at the Army Audit Agency and the Naval Audit Service.

Results. The evaluation disclosed no exceptions to the policies and procedures the Air Force Audit Agency used to determine audit requirements and request audit resources. In addition, nothing came to our attention to indicate that the Air Force Audit Agency had any impairment to independence. Overall customer satisfaction with AFAA generally increased since FY 1995, and the AFAA had exceeded its performance plan goals relating to customer satisfaction. In addition, AFAA customers indicated that they were satisfied with the planning process.

Management Comments. We provided a draft of this report on July 22, 1999. Because the draft report contained no findings or recommendations, written comments were not required. The AFAA did however provide some editorial type changes to the draft report that we considered in preparing this final report.

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Background

Air Force Audit Agency. According to Air Force Policy Directive 65-3, "Internal Auditing," August 10, 1993, the Air Force Audit Agency (AFAA) will be placed organizationally to maintain the independence required by both public law and the standards of the U.S. Comptroller General. Auditors will not perform line, staff, or other collateral duties that would impair that independence. The Directive further states that all Air Force organizations, functions, activities, and levels of operations may be audited. In addition, the AFAA will without limitation, select activities for audit, determine the scope of audit work, and report results. The Auditor General establishes the overall program for internal audits within the Air Force in accordance with existing statutes, Comptroller General audit standards, and DoD policies.

Mission. The mission of the AFAA is to provide all levels of Air Force management with independent, objective, and quality audit services that include:

- reviewing and promoting economy, effectiveness, and efficiency of operations;
- evaluating programs and activities and assisting management in achieving intended results; and
- assessing and improving Air Force fiduciary stewardship and the accuracy of financial reporting.

Organization. The AFAA line operations are managed through the following three directorates.

- The Financial and Support Audits Directorate develops and manages audits relating to financial management, forces management, personnel, support services, environmental issues, communications, intelligence operations, and health care.
- The Materiel and Systems Audits Directorate develops and manages audits relating to maintenance, procurement, supply, automated data processing, financial management systems, transportation, and weapon systems. In addition, the directorate also manages the Materiel Audit Region Division that includes area audit offices at 10 locations.
- The Field Activities Directorate manages Air Force installation-level audit work at 46 area audit offices. The Directorate supervises those offices through Eastern and Western Audit Region Divisions.

Types of Engagements. The AFAA uses four types of service to evaluate the operations in the Air Force.

- Centrally directed audits are Air Force-wide evaluations that primarily serve Headquarters Air Force and major commands. Those audits are accomplished concurrently at multiple locations and are planned and scheduled by either the Financial and Support Audits Directorate located at March Air Reserve Base, California, or the Materiel and Systems Audits Directorate, Wright-Patterson Air Force Base, Ohio.
- Area audit office audits are planned and scheduled by area audit office chiefs. The audits evaluate installation-level operations at various Air Force bases.
- Commander requested audits address priority problem areas. If the audit does not disclose irregularities such as fraud or public law violations, the results are reported only to the requesting commander.
- Management Advisory Services (MAS) are services rendered, other than audits. The services include consultations, advisory services, implementation services, transaction and support services, and product services.

Objectives

The overall objective of the evaluation was to assess the process for determining audit requirements and for requesting audit resources. We also determined whether the planning process was responsive to management needs and whether policy or resource constraints impaired auditor independence. We plan to develop a best practice report based on this review and similar reviews at the Army Audit Agency and the Naval Audit Service. See Appendix A for a discussion of the evaluation scope and methodology and prior coverage.

Determining Audit Requirements and Requesting Resources

AFAA used a combination of risk assessments, customer surveys, and priorities established by the DoD-wide joint planning groups to determine audit requirements. AFAA requested and received its audit resources in a manner similar to the process other DoD agencies used to request and receive resources. Overall customer satisfaction with AFAA generally increased since FY 1995, and the AFAA had exceeded its performance plan goals relating to customer satisfaction. In addition, AFAA customers indicated that they were satisfied with the planning process. Finally, AFAA had a specific policy governing the types of reviews and independence issues, and it had sufficient resources to perform mandatory and high priority audits.

Audit Requirements – Centrally Directed Audits

AFAA Planning Process Review. In FY 1997 the AFAA conducted a review of the audit planning process. During the review, it was found that, in many instances, it took too long to complete an audit after receiving an audit suggestion from a customer and including the suggestion in the annual plan. The review also concluded that more effort should be focused on obtaining audit suggestions from senior-level customers. As a result of the review, the AFAA changed the audit planning process including the audit plan itself. The AFAA went from a yearly audit plan to an 18-month plan that is updated every 6 months. The AFAA also modified the way it solicited suggestions. For example, at the major command and air staff level, a formal letter requesting audit subjects was supplemented with informal oral solicitations each 6 months. Suggestions from the Air Force Secretariat level were still requested by letter once a year. However, the audit staff contacted these officials at least semi-annually to discuss potential audit issues. AFAA also formally identified who its customers were and assigned specific AFAA audit divisions to provide audit coverage for those customers.

Identifying Audit Requirements. AFAA used two processes to identify potential audit issues for centrally directed audits, a formal process and an informal process. The formal process involved the AFAA formally requesting topics from the Air Force Secretariat, air staff, and major command commanders once a year. The informal process consisted of AFAA personnel interfacing and talking to Air Force management personnel on a periodic basis and identifying potential subjects throughout the year. The informal process also included interfacing with area audit offices that submitted potential centrally directed audit subjects throughout the year. After the potential audit issues were identified and documented, AFAA evaluated them based on magnitude, management interest, budget impact, and whether or not the subject was an Air Force-wide issue. After evaluating the potential issues, further research was done on topics that still were considered to have potential. AFAA compiled

research folders on potential subjects and presented those subjects to Air Force management. Air Force management revalidated those topics that were not completed in the previous plan.

Formulation of Audit Plan. For centrally directed audits, AFCAA issued an 18-month audit plan that was updated and published every 6 months. Work that the area audit offices initiated was not included in the audit plan. The Operations Directorate at Headquarters AFCAA provided guidance for formulating the audit plan. After receiving input from the Financial and Support Audits Directorate and the Materiel and Systems Audits Directorate, the Operations Directorate was responsible for actually preparing and publishing the 18-month audit plan. In addition, the audit plan was put on the AFCAA website.

Audit Requirements – Area Audit Office Initiated Work

During FY 1998, area audit offices spent about 48 percent of their time on centrally directed audits, while 52 percent of the time was expended for locally initiated work. Nonetheless, the area audit offices still produced a detailed annual audit plan for work at the installation level. The area audit offices used a combination of customer focus and risk-based analysis to identify audit requirements and develop an audit plan for locally initiated work.

Identifying Audit Requirements. At area audit offices, team leaders assigned to specific sites were responsible for interfacing with Air Force management on a daily basis and for identifying future audit issues throughout the year. Also, office chiefs interfaced with management to identify potential audit issues, and each auditor submitted four potential audit subjects per year to the office chief.

Risk-Based Analysis. After potential audit subjects were identified, a risk-based analysis was used to develop the audit plan. The audit subjects were evaluated and scored using nine risk-assessment factors (see Appendix B). The audit subjects are then ranked according to the risk-assessment scores. The audit subject with the highest estimated risk would be at the top of the list for potential audit. Although an area may score high, the office chief can overrule the calculated score and move the subject higher or lower based on judgment, balance within the audit plan, or other limiting factors involving personnel or cost. However, the higher or lower priority must be justified. After the process is completed, the annual audit plan is prepared.

Audit Resources

AFCAA requests and receives its audit resources in a manner similar to the process other DoD agencies used to request and receive resources. As a result, AFCAA exhibited no unusual resource or request problems.

Request for Resources. The number of authorized personnel within AFAA drives the request for audit resources. Table 1 shows the number of AFAA authorized personnel from FY 1997 through FY 2003.

Table 1. AFAA Authorized Personnel

<u>FY 1997</u>	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>
922	891	847	820	803	803	803

The AFAA has made organizational changes in response to its personnel reductions. AFAA officials stated that these changes, along with the application of information technology innovations, will allow them to continue providing adequate audit coverage across the spectrum of Air Force activities. However, these officials stated that further reductions beyond the 803 authorized for FY 2001 could negatively impact their ability to provide adequate audit coverage of some key Air Force functions.

Funding. In FY 1998, the AFAA was authorized 891 personnel and was funded accordingly. For FY 1999, the AFAA was authorized 847 personnel and will be funded accordingly. Funding for AFAA resources was accomplished through the program objective memorandum process, similar to the process that other DoD agencies used. The program objective memorandum was the Military Department resource allocation decision process in response to and in accordance with Defense budgetary guidance. Table 2 shows the increase in AFAA expenditures for audit resources from FY 1994 through FY 1998.

Table 2. AFAA Expenditures
(millions)

Account	<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>	<u>FY 1998</u>
Payroll	\$49.62	\$53.60	\$55.10	\$58.14	\$59.79
Travel	2.89	3.02	3.07	3.48	4.42
Equipment	1.62	1.76	2.14	1.31	0.00
Other	0.90	1.03	0.97	0.54	0.68
Total	\$55.03	\$59.41	\$61.28	\$63.47	\$64.89

Customer Satisfaction With the AFAA Planning Process

AFAA has established a planning process responsive to the management needs of the Air Force. Overall customer satisfaction with AFAA generally increased since FY 1995, and the AFAA has exceeded its performance plan goals relating to customer satisfaction. In addition, AFAA customers indicated that they were satisfied with the planning process.

Customer Satisfaction Questionnaires. AFAA FYs 1997 through 2001 Performance Plan included 13 measurement areas and associated goals. Measurement area 5 related to customer satisfaction. Two performance measures under measurement area 5 related to customer satisfaction: one for centrally directed audits and one for area audit office initiated work. The goal of the performance plan was to obtain a score of 4.0 or better (out of a possible 5) for centrally directed audits and 4.03 or better for area audit office initiated work. A customer satisfaction questionnaire was the tool AFAA used to measure progress in measurement area 5. The questionnaire solicited feedback on how well audits were performed, thus allowing AFAA managers means through which to identify performance strengths, weaknesses, and trends. AFAA began using the customer satisfaction questionnaire in FY 1994.

Overall Customer Satisfaction Rating. Personnel within the AFAA Director of Staff maintained the databases used to track and report trend information on customer satisfaction. The same customer satisfaction questionnaire was used for both centrally directed audits and area audit office initiated audits. AFAA personnel computed the overall rating by averaging the ratings in the five subject areas of the questionnaire. The five areas were value added, professionalism, timeliness, oral communication, and written communication. Table 3 shows customer satisfaction ratings of AFAA.

**Table 3. Overall Customer Satisfaction
(of a possible 5)**

Type of Audit	Goal	FY 1995	FY 1996	FY 1997	FY 1998
Centrally directed audits	4.00	3.92	4.11	4.05	4.23
Area audit office initiated audits	4.03	4.03	4.00	4.16	4.19

Customer Satisfaction. A survey of Air Force customers revealed positive opinions for the audit planning process. We discussed the AFAA planning process with seven major AFAA customers. Those customers expressed overall satisfaction with the AFAA planning process and expressed no complaints or concerns.

Auditor Independence

Nothing came to our attention to indicate that AFAA independence was impaired due to policy or resource constraints. AFAA had specific policies governing different types of AFAA reviews and independence issues, and it had sufficient resources to conduct mandatory and high priority audits.

Policy. AFAA had a specific policy governing the different types of AFAA reviews. From FY 1995 through FY 1998, AFAA steadily increased its coverage of consulting and requested audits, especially consulting. Direct auditor days for consulting increased almost 700 percent from FY 1995 through FY 1998. From FY 1995 through FY 1998, AFAA requested work increased from 16,765 auditor days to 23,084 (40 percent) auditor days (see Table 4).

**Table 4. Requests and Consulting Work
(auditor days)**

Type of Work	FY 1995	FY 1996	FY 1997	FY 1998
Requests	16,765	17,435	22,395	23,084
Consulting	2,287	5,375	6,162	15,672

Agency Instruction. In 1998, AFAA published Audit Agency Instruction 65-103, "Management and Administration," October 30, 1998. Section E of the Instruction addresses AFAA policy and procedures for performing services other than audits. Services other than audits are grouped under the heading MAS (Management Advisory Services). The Instruction states that when AFAA provides a MAS, all staff must comply with the applicable standards. However, standards for a MAS are not always the same standards as generally accepted Government auditing standards. The Instruction outlines the differences for the general, field work, and reporting standards to include independence.

AFAA Instruction 65-103 states that questions of independence arise if an auditor performs a MAS for a client when the auditor has a relationship that could appear to impair objectivity and when auditors contribute toward management decisions and then review that decision during an audit. AFAA auditors can perform a MAS if the relationship is acceptable to the client. However, when performing audits, supervisors must assign staff who did not contribute toward the client management decisions or the implementation of the client management decisions.

According to the Instruction, independence is presumed impaired when internal auditors, subsequent to performing a MAS, audit the specific activity for which they had authority or responsibility during the MAS. The Instruction states that

AFAA should prohibit staff from participating in related audits for a reasonable time period (about 1 year) after completing the MAS. Also, in no case should an auditor review a function created as a result of the auditor's contribution to management's decision. Finally, the Instruction states that if a local MAS issue is subsequently covered by a centrally directed audit, the audit control point may have to exclude the location from participating in the audit or request that another office perform the audit work at the location that completed the management advisory service. Thus, AFAA developed thorough guidelines for AFAA auditors to follow when conducting a MAS.

Effect of Resources on AFAA Independence. We found no evidence suggesting that resource constraints had a negative impact on AFAA independence. AFAA was able to perform mandatory audits required by statute (for example, Chief Financial Officers Act). Similar to most DOD Components, AFAA faced resource constraints at the same time as workload growth; however, AFAA had sufficient resources to perform mandatory and high priority audits. In FY 1998, AFAA spent 21,770 (18 percent) direct auditor days of a total 124,241 days doing statutorily required audits. The remaining auditor days during the fiscal year were spent primarily on self-initiated audits and audits requested by Air Force management.

Conclusion

The evaluation disclosed no exceptions to the policies and procedures that AFAA used to determine audit requirements and to request audit resources. In addition, nothing came to our attention to indicate that AFAA had any impairment to independence. Since the start of the customer satisfaction program in FY 1994, surveys have shown a general increase in positive feedback from users of AFAA reports and services.

Appendix A. Evaluation Process

Scope and Methodology

We reviewed DoD, Air Force, and AFAA policies and procedures in force from 1991 through 1999 that related to the process for determining audit requirements and requesting audit resources. We also discussed with AFAA personnel what changes were made to the planning process since FY 1997. In addition, we reviewed the AFAA 18-month audit plan and the AFAA process for determining audit requirements for centrally directed and area audit office work. To determine whether the planning process was responsive to management needs, we reviewed customer satisfaction questionnaires from FY 1994 through FY 1998 and discussed the planning process with seven major AFAA customers. To determine whether policy or resource constraints were impairing auditor independence, we reviewed FY 1994 through FY 1999 budget and workload data. We reviewed AFAA policy to determine whether its policy specifically addressed independence issues for consulting work. Concerning resource constraints, we reviewed budget and manpower data and discussed with AFAA personnel whether the lack of AFAA resources might prevent the AFAA from performing critical or necessary work and thus impair auditor independence.

DoD-Wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, DoD has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal.

Objective: Maintain highly ready joint forces to perform the full spectrum of military activities. **Goal:** To maintain a highly ready joint force to perform the full spectrum of military activities by improving force management procedures throughout DoD. (DoD-5.3)

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Functional Area. **Objective:** To implement the Government Performance and Results Act. **Goal:** Establish the framework for integrating the Government Performance and Results Act into the DoD Planning, Programming, and Budget System. (FM-6.2)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Use of Computer-Processed Data. We did not use computer-processed data to perform this evaluation.

Evaluation Type, Dates, and Standards. We performed this program evaluation from March 1999 through May 1999 in accordance with standards issued and implemented by the Inspector General, DoD. The scope of the evaluation was limited in that we did not include tests of the management controls.

Contacts During the Evaluation. We visited or contacted individuals and organizations within DoD. Further details are available upon request.

Summary of Prior Coverage

During the last 5 years, the Inspector General, DoD, issued one report addressing the Military Department audit agencies process for determining audit requirements and requesting resources.

Inspector General

Inspector General, DoD, Report No. PO 99-6-005, "Army Audit Agency Process for Determining Audit Requirements and Requesting Resources," May 27, 1999.

Appendix B. Risk Assessment Factors for Area Audit Office Initiated Work

The following are the nine risk assessment factors that AFAA area audit offices used to evaluate and rank potential audit subjects.

Mission and goals. Importance of the audit subject to the mission statement and goals of the audit entity.

Fraud, waste, or abuse. Vulnerability of the audit subject to fraud, waste and abuse.

Management suggested subjects. Installation official's request and suggest the audit subject.

Resources. The audit subject's dollar value of transactions, number of people involved, and asset value.

Public criticism. Sensitivity of the audit subject to adverse public opinion or criticism.

Public law. Audit subject impacted by public law.

Management controls. Management controls to protect Government interests and assets and promote the accuracy of reported financial results.

Prior audit coverage. Amount of time since last audit.

Mission changes. Changes in the audit entity's mission, products and services, personnel, systems, or financial results.

Appendix C. Report Distribution

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Auditor General, Department of the Air Force

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